Hunton & Williams

Client Alert

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D&O Carrier Must Cover Seized Bank's Defense Costs

On October 8, 2014, in *St. Paul Mercury Ins. Co. v. Michael S. Hahn, et al.*, Case No. SACV 13-0424 AG (RNBx), a California federal district court ruled that St. Paul Mercury Ins. Co. (referred to as Travelers) must defend former directors and officers of a defunct bank who were sued by the FDIC — as the receiver for Pacific Coast National Bank — against claims of negligence and breaches of fiduciary duty. The Court rejected Travelers' reliance on the "Insured v. Insured" exclusion to escape coverage and, in the process, aligned itself with the majority of courts throughout the country that have held that the "Insured v. Insured" exclusion does not unambiguously exclude from coverage lawsuits by the FDIC.

Background

In November 2009, the Office of the Comptroller of the Currency closed Pacific Coast National Bank (the Bank) and appointed the FDIC as receiver for the Bank. Shortly thereafter, the FDIC sued several of the Bank's former directors and officers for negligence, gross negligence and breaches of fiduciary duty. The defendant directors and officers tendered the lawsuit and sought coverage pursuant to Travelers' "Management Liability Insuring Agreement," which provided coverage for "loss for which the Insured Person [including the directors and officers] … become legally obligated to pay on account of any Claim … for a Management Practices Act." Travelers denied coverage, relying on the "Insured v. Insured" Exclusion, which states that the "Insurer shall not be liable for Loss [including Defense Costs] on account of any Claim made against any Insured … brought or maintained by or on behalf of any Insured or Company [including the Bank] in any capacity, except: (a) a Claim that is a derivative action brought or maintained on behalf of the Company by one or more persons who are not Directors or Officers and who bring and maintain such Claim without the solicitation, assistance or active participation of any Director or Officer."

In evaluating cross-motions for summary judgment, the Court's main consideration was whether the FDIC, as the receiver, had brought the lawsuit "on behalf of" the Bank and, therefore, subject to the "Insured v. Insured" exclusion.

Court's Ruling

In denying Travelers' motion, and in turn granting the FDIC's motion, the Court held that the phrase "on behalf of" is ambiguous when applied to the role of the FDIC and, therefore, determined that Travelers owed a duty to defend. The Court noted that different courts considering the "Insured v. Insured" exclusion have reached varying conclusions and by definition, the varying results confirm that the "Insured v. Insured" exclusion was ambiguous and subject to different interpretations. "There can be little doubt that repeated disputes over the IvI Exclusion have placed insurers on notice that it is ambiguous."

United States District Judge Andrew J. Guilford also properly noted the importance that "exclusionary clauses are interpreted narrowly against the insurer" and exclusionary clauses will be enforced only if they are conspicuous, plain and clear. Here, the phrase "on behalf of" was far from clear and conspicuous and Travelers had not met its burden to prove the applicability of the exclusion. The Court alluded to the fact that Travelers had the opportunity to make clear in the Policy that the "Insured v. Insured" Exclusion did apply to the FDIC, and could have done so by utilizing an optional regulatory exclusion that explicitly names the FDIC. The Court determined that Travelers chose not to include such a provision here and, therefore, "Travelers cannot now benefit from the ambiguity."

Implications

The *St. Paul Mercury* decision is consistent with the majority of the decisions throughout the country that have refused to exclude coverage based on the carriers' attempt to assert the "Insured v. Insured" Exclusion. As a result of the 2008 financial crisis, several financial institutions have faced similar issues as raised in the *St. Paul Mercury* decision and insurance coverage may be the only viable resource that these former directors and officers have to mount a sufficient defense. This decision also confirms the important policy interpretation standard that policy provisions that are capable of two or more reasonable constructions must be interpreted to protect the objectively reasonable expectations of the policyholder. Furthermore, exclusionary clauses should be enforced against a policyholder only if such clauses are conspicuous, plain and clear.

St. Paul Mercury is another reminder that policyholders should not accept a carrier's reflexive decision to assert potentially ambiguous exclusions to avoid coverage. Policyholders should carefully consider all coverage denials and push back, where appropriate, particularly where the policy provision on which the denial is based may be subject to more than one reasonable interpretation.

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Contacts

Walter J. Andrews
wandrews@hunton.com

Lon A. Berk
lberk@hunton.com

Lawrence J. Bracken, II
lbracken@hunton.com

John C. Eichman
jeichman@hunton.com

Robert J. Morrow
rmorrow@hunton.com

Syed S. Ahmad
sahmad@hunton.com

Michael S. Levine
mlevine@hunton.com

Sergio F. Oehninger
soehninger@hunton.com

William T. Um
wum@hunton.com